Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	

COMMENTS OF SBC COMMUNICATIONS INC.

CHRISTOPHER M. HEIMANN
GARY L. PHILLIPS
PAUL K. MANCINI

Attorneys For:
SBC COMMUNICATIONS INC.
1401 Eye Street, NW
Suite 400
Washington, D.C. 20005
(202) 326-8909 – Phone
(202) 408-8745 – Facsimile

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COMMENTS OF SBC COMMUNICATIONS INC.[1]

I. INTRODUCTION AND SUMMARY

The Commission and Joint Board are right to be concerned about the proliferation of demands on the federal universal service fund (USF) and the long-term sustainability of universal service support in today's increasingly competitive telecommunications environment.[2] And while the Commission appropriately should reconsider its existing rules regarding high cost support in study areas served by competitive eligible telecommunications carriers (CETCs) in light of these trends, it must recognize that reforming those rules, at most, will have a modest impact on the sustainability of universal service. Unless the Commission initiates more fundamental reform, including finally tackling the intractable problem of widespread reliance on implicit subsidies in intrastate rates to support universal service, CETCs will continue to have strong incentives to pursue targeted entry strategies and exploit arbitrage opportunities by cherry-picking the most profitable customers and leaving incumbent LECs to serve low-revenue and high cost customers. In the end, consumers will be the losers, contrary to section 254, as incumbent LECs face increasing pressure to seek rate hikes or to curtail service to make up for lost implicit subsidies.

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[1] SBC Communications Inc. files these comments on behalf of itself and its operating company affiliates, including: Southwestern Bell Telephone, L.P.; Nevada Bell Telephone Company; Pacific Bell Telephone Company; Illinois Bell Telephone Company; Indiana Bell Telephone Company, Incorporated; Michigan Bell Telephone Company; The Ohio Bell Telephone Company; Wisconsin Bell, Inc.; The Woodberry Telephone Company; and The Southern New England Telephone Company.

[2] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Notice of Proposed Rulemaking*, 19 FCC Rcd 10805, at paras. 1, 32 (rel. June 8, 2004) (*Notice*).

The Commission cannot continue its incremental approach to universal service reform. Rather, as the 10th Circuit made clear, it must adopt a holistic view that spans both federal and state jurisdictions, and undertake fundamental reform to ensure that federal and state policies and support mechanisms work together to meet the requirements of section 254.[3] The Commission also must return to first principles, with a renewed, critical focus on ensuring that, consistent with the language and goals of section 254, high-cost support is provided only to the extent that market prices for essential services would not be affordable.

Although strengthening the standards for designating additional ETCs is a positive step, which SBC supports, further action is required. In the near term, the Commission should, as SBC previously expressed to the Joint Board, limit high-cost support for CETCs only to services that meet the definition of universal service and that are offered at an affordable rate.[4] The Commission also should modify the way in which it calculates support for CETCs by limiting such support to the lesser of the difference between the affordable rate for service and the CETC's actual costs or the per-line support available to the ILEC, and thus ensure that CETCs receive no more support than necessary to provide essential services at an affordable rate.[5] Finally, the Commission should exercise its authority under section 254 to require all providers of services capable of sending traffic to or receiving traffic from the PSTN (including providers of cable modem and IP-enabled services that market their services as substitutes for conventional circuit-switched services) to contribute to universal service, and thus ensure that the Commission's universal service obligations do not improperly distort the market in favor of providers that benefit from, but do not support, the Commission's universal service policies.[6]

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[3] *Qwest Corp. v. FCC*, 258 F.3d 1191, 1203-04 (10th Cir. 2001).

[4] Comments of SBC Communications Inc., CC Docket 96-45 at 7-9 (filed May 5, 2003) (SBC Joint Board Comments), attached hereto as Attachment A.

[5] *Id.* at 9-11.

[6] Comments of SBC Communications Inc., WC Docket No. 04-36, at 116-120 (filed May 28, 2004); Reply Comments of SBC Communications Inc., WC Docket No. 04-46, at 83- 86 (filed July 14, 2004).

The Commission already has ample authority and justification for taking each of these steps, and should do so quickly.[7]

In the longer term, the Commission must finally take steps to address the problem of implicit subsidies in intrastate rates. As Congress, the courts and even this Commission have long recognized, by eliminating barriers to entry in the local telecommunications market, the 1996 Act eliminated the structural underpinnings of the complex system of price controls and implicit subsidies used to support universal service. Congress therefore required the Commission and states to replace existing universal service support mechanisms with new mechanisms that are "equitable and nondiscriminatory," and "specific, predictable, and sufficient" to "preserve and advance universal service."[8] And, while implicit subsidies have been reduced at the federal level, the states have done little, if anything, to eliminate their reliance on implicit subsidies to support universal service. If the past is any guide, absent Commission action to induce the states to eliminate implicit subsidies, the states will continue to ignore the problem. The Commission therefore must adopt rules to induce the states to rationalize intrastate rates by replacing implicit subsidies with explicit support and permitting rates to rise to levels that are self-supporting and affordable. Only by doing so will the Commission ensure that federal and state support mechanisms are sufficient to preserve and advance universal service consistent with the requirements of section 254.

II. THE JOINT BOARD'S PROPOSED GUIDELINES SHOULD BE MANDATORY REQUIREMENTS

SBC agrees with the Joint Board that a rigorous ETC designation process is necessary to ensure that designation of additional ETCs in a particular area will promote the goals of section 254, and guarantee that applicants are fully qualified to receive designation as ETCs and

[7] In its Recommended Decision, the Joint Board declined to modify the basis of support for CETCs, purportedly on the ground that it lacked an adequate record to support such action. *Notice* at para. 127. However, as SBC explained in its comments before the Joint Board, the existing methodology for calculating support for CETCs is inconsistent with the express terms of the Act, and the goals of universal service. SBC Joint Board Comments at 9-11. Consequently, the Commission is obliged to modify its method of calculating support for CETCs notwithstanding the Joint Board's decision to punt on the issue.

[8] 47 U.S.C. §§ 254(b)(4) & (5), 254(d), 254(e), and 254(f).

prepared to serve all customers within the affected area.[9] SBC further believes that the Joint Board's proposed guidelines could provide the necessary rigor, and establish a more consistent, predictable process for designating ETCs across the country. But, to do so, the Commission must adopt the guidelines as mandatory minimum requirements for ETC status rather than permissive guidelines that states may follow or ignore at their discretion.

A. The Commission has authority to adopt the guidelines as requirements

The Commission has ample authority to adopt the guidelines proposed by the Joint Board as mandatory minimum requirements for designation as an ETC. Section 254(a) of the Act specifically authorizes the Commission to adopt rules to implement section 214(e), which provides for the designation of ETCs.[10] Moreover, section 201(b) of the Act authorizes the Commission to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act."[11] And the Supreme Court has made clear that this section "*explicitly* gives the FCC jurisdiction to make rules governing matters to which the 1996 Act applies."[12] The Court emphasized that, "with respect to the matters addressed by the 1996 Act," the "Federal Government . . . unquestionably has" "taken the regulation of local telecommunications competition away from the States."[13] The Court further explained that, "[i]f there is any 'presumption' applicable to th[e] question" whether state commissions' administration of "the new *federal* regime is to be guided by federal-agency regulation," "it should arise from the fact that a federal program administered by 50 independent state agencies is surpassing strange."[14]

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[9] Notice at paras. 40, 42-44.

[10] 47 U.S.C. § 254(a) (requiring the Commission to institute a proceeding to consider changes to its rules to, among other things, "implement section[] 214(e)").

[11] 47 U.S.C. § 201(b).

[12] *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 380 (1999) (emphasis in original).

[13] *Id.* at 379.

[14] *Id.* (emphasis in original).

As the Joint Board recognized, "[w]hile Congress delegated to individual states the right to make ETC decisions, collectively these decisions have national implications. They affect not only the dynamics of competition in the areas subject to the proceedings, but also the national strategies of new entrants. They also affect the overall size of the federal fund."[15] Particularly where, as here, the decisions of individual state commissions have national consequences and affect rate payers across the country, it would, indeed, be surpassing strange if the Commission did not exercise its authority to establish minimum mandatory requirements for ETC status. Absent such requirements, states inevitably will reach inconsistent conclusions and be free to act on parochial incentives to inflate the amount of federal high-cost support flowing into their jurisdictions. Only the Commission has a national view, and only it can ensure that the ETC decisions of one state do not unnecessarily or unreasonably burden rate payers in other states by needlessly inflating the fund. Consequently, it is imperative that the Commission establish minimum mandatory requirements for ETC status to ensure that the high-cost support mechanism is administered fairly and consistent with the requirements of section 254.[16]

B. The proposed guidelines would be reasonable mandatory requirements

The Commission should adopt the Joint Board's proposed guidelines as mandatory minimum requirements for ETC status. As the Joint Board correctly observed, under the statute, an ETC must: (1) be prepared to serve all customers within a designated service area; (2) offer the services that are supported by the Federal universal service support mechanism using its own facilities or a combination of its own facilities and resale; (3) advertise the availability of such services; and (4) be willing to be the sole ETC if other ETCs exercise their right to relinquish their ETC (and therefore their carrier of last resort) status pursuant to section 214(e)(4).[17] In

[15] *Notice* at para. 47.

[16] States would be free to establish additional requirements to ensure that designation of additional ETCs is consistent with the public interest, convenience and necessity. *See Texas Office of Public Util. Counsel v. FCC*, 183 F.3d 393, 418 (5th Cir. 1999).

[17] *Notice* at paras. 42, 50.

addition, before it may designate more than one carrier as an ETC in a particular area, a state commission must find that doing so is consistent with the public interest, convenience, and necessity.[18] The guidelines proposed by the Joint Board would ensure that ETCs meet these statutory requirements, and that designation of more than one ETC in a given area is consistent with the public interest.[19]

Adequate Financial Resources. Section 214(e) requires any carrier designated as an ETC to be prepared to serve all customers within a designated service area and to be the carrier of last resort (COLR) if other ETCs in that area exercise their right to relinquish their ETC status.[20] To ensure that carriers seeking ETC status meet these requirements, states plainly must evaluate whether ETC applicants have the financial resources to provide supported services throughout the relevant service area. Moreover, as the Joint Board recognized, it would not be prudent, nor would it serve the public interest, to provide universal service funding to a carrier that cannot meet its statutory obligations.[21] The Commission therefore should require that carriers seeking ETC status must demonstrate that they have adequate financial resources to meet their obligations as an ETC.

Commitment and Ability to Provide Supported Services. Section 214(e)(1) also requires any carrier designated as an ETC to offer the services supported by the federal universal service support mechanism throughout the service area for which designation is received. To ensure that a carrier seeking CETC status meets this requirement, the Commission should require that any

[18] 47 U.S.C. § 214(e)(2) ("Upon request and consistent with the public interest, convenience, and necessity, the State commission may, in the case of an area served by a rural telephone company, and shall, in the case of all other areas, designate more than one common carrier as an eligible telecommunications carrier for a service area . . .").

[19] If the Commission does not make the proposed guidelines mandatory requirements for ETC status (which, for the reasons articulate herein, it should), it still should adopt the them as guidelines to send a signal to the states that the bar should be raised to ensure that carriers seeking ETC status are ready, willing and able to fulfill their statutory obligations, including the obligation to serve as the carrier of last resort if the incumbent ETC exercises its right to relinquish its ETC status.

[20] 47 U.S.C. § 214(e)(4).

[21] *Notice* at para. 53.

CETC applicant must demonstrate that it is capable and committed to provide all supported services throughout the service area to all customers who make a reasonable request for service. As part of this showing, a CETC applicant should be required to submit a formal, enforceable plan for reaching all such customers either through its own facilities or through a combination of its own facilities and resale of another carrier's services at the time it submits its application for ETC status, and to show how it will meet its COLR obligations in the event other ETCs relinquish their ETC status.

Ability to Remain Functional in Emergencies. The Commission should require that any carrier seeking CETC status be held to the same standards as the incumbent ETC. Insofar as a CETC must be prepared to serve as the COLR in the event the incumbent ETC exercises its right to relinquish ETC status, CETCs must be able to meet the same network security, reliability and integrity standards as the incumbent. As the Joint Board noted, the security of a carrier's network and its ability to protect critical telecommunications infrastructure plainly is a critical public interest consideration.[22]

Consumer Protection. The Commission also should require CETCs to comply with the same consumer protection requirements (including, for example, truth-in-billing and CPNI requirements) as apply to the incumbent ETC. Again, a CETC must be prepared to step into the shoes of the incumbent and serve as the COLR if the incumbent exercises its right to relinquish its designation as an ETC, and thus must abide by whatever consumer protection standards are applicable to the incumbent ETC. Moreover, requiring CETCs to comply with the consumer protection obligations applicable to the incumbent also is necessary to ensure a level playing field.[23] Plainly, there can be no justification for tipping the regulatory scale in favor of one carrier over another when both seek federal universal service support.

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[22] *See Notice* at para. 61.

[23] SBC disagrees with the Joint Board that regulatory parity in and of itself would not justify imposing the same consumer protection requirements on ETCs and CETCs alike. *See Notice* at para. 62.

Local Usage. As the Joint Board observed, the Commission has determined that ETCs must provide some minimum local usage as part of their "basic service" package of supported services.[24] However, the Commission has not specified how much many minutes of local usage an ETC must provide. SBC does not object to the establishment of a minimum local usage requirement to obtain ETC status, but believes that this question is better addressed in the context of the Commission's review of the definition of universal service pursuant to section 254(c). SBC further must emphasize that any such requirement must apply equally to ETCs and CETCs, as required by the statute.[25]

Public Interest. The Commission should make clear to the states that they must apply a rigorous public interest analysis when considering whether to grant new entrants ETC status. Such an analysis is necessary to prevent unbridled and unnecessary growth in the federal high-cost fund due to the multiplication of redundant connections to the PSTN. Particularly inasmuch as the federal universal service mechanism requires end users across the country to subsidize rates in high cost areas, the Commission should require the states to consider, among other things, whether granting ETC status to additional carriers would place undue strains on the fund and is necessary to achieve the goals of section 254 as part of their public interest analysis. In particular, states should be required to consider the demographic and economic characteristics of serving a particular area (*e.g.*, population density, terrain, the number of carriers already serving a particular area) to determine whether it is in the public interest to designate additional ETCs in that area. Both Commissioner Martin and Joint Board Member Billy Jack Greg rightly have questioned the propriety of using universal service support to subsidize multiple carriers to serve areas in which costs are prohibitively expensive for even one carrier.[26] Where the costs of

[24] *Notice* at para. 66.

[25] 47 U.S.C. § 254(e)(1)(A) (requiring ETCs to offer supported services throughout the service area).

[26] *Notice*, Attachment, Separate Statement of Commissioner Kevin J. Martin, Dissenting in Part, Concurring in Part ("I have concerns with policies that use universal service as a means of creating 'competition' in high cost areas. In my view, the main goals of the universal service program are to ensure that all consumers – including those in high cost areas – have access at affordable rates. I remain hesitant to subsidize multiple competitors to serve areas in which costs are prohibitively expensive for even one carrier.") (citations omitted); *Id.*, Separate Statement of Billy

serving a particular area are so high that the existing carrier(s) serving that area already require significant high-cost support, it would not make sense to designate additional ETCs for that area unless those carriers demonstrably are more efficient and thus can serve the area at lower cost than the incumbent ETC.

III. THE COMMISSION SHOULD LIMIT SUPPORT TO PRIMARY LINES, BUT ONLY AS PART OF A COMPREHENSIVE REFORM OF UNIVERSAL SERVICE AND ONLY AFTER RESOLVING LOGISTICAL ISSUES

For the reasons articulated in its comments before the Joint Board, SBC generally supports limiting universal service support to primary residential and single-line business lines.[27] However, imposing such a limit should be adopted only as part of more comprehensive universal service reform. For example, the Commission could not eliminate support for non-primary lines without taking steps to ensure that all carriers serving high cost areas have flexibility to reform their rate structures to fully recover the costs of providing non-essential, non-primary connections and services; failure to do so would be confiscatory. Elimination of support for non-primary lines therefore would have to be contingent on and concomitant with the grant of pricing flexibility for non-primary lines.

Before the Commission considers eliminating support for non-primary lines, it also must fully explore the logistical and administrative costs of limiting support only to primary lines because the costs and burdens of implementing any such limitation could well exceed the benefits. And, without knowing the details of how the Commission would implement such a limitation, it is difficult to know what the costs and burdens might be. For example, requiring carriers or USAC to establish balloting procedures for identifying primary lines, and/or requiring carriers to establish detailed record keeping requirements could be impose significant costs and burdens, which ultimately would be borne by rate payers. Until the Commission offers a

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Jack Greg, Director of the Consumer Advocate Division, Public Service Commission of West Virginia ("I believe that there are certain areas of this country where it is so expensive to provide service that it makes no sense to have more than one carrier subsidized by the federal universal service fund.").

[27] SBC Joint Board Comments at 12-16 (attached hereto).

detailed proposal, parties cannot comment meaningfully on the potential costs and implications of limiting support to primary lines. In addition, the Commission should not adopt a primary line restriction before interested parties, such as SBC, have had an opportunity to comment on a detailed proposal. But, whatever the Commission does, it must ensure that the administrative costs of limiting support only to primary lines is borne by the fund, not just incumbent ETCs.

IV. CONCLUSION

For the foregoing reasons, the Commission should modify its high cost universal service support rules as discussed herein.

Respectfully submitted,

/s/ Christopher M. Heimann

CHRISTOPHER M. HEIMANN
GARY L. PHILLIPS
PAUL K. MANCINI

SBC COMMUNICATIONS INC.

1401 Eye Street, N.W., Suite 400
Washington, D.C. 20005
Phone – 202-326-8909
Facsimile – 202-408-8731

Its Attorneys

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Attachment A

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CHRISTOPHER M. HEIMANN
GARY L. PHILLIPS
PAUL K. MANCINI

SBC COMMUNICATIONS INC.

1401 Eye Street, NW,
Suite 400
Washington, D.C. 20005
202-326-8909 – phone
202-408-8745 - facsimile

Its Attorneys

May 5, 2003

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SBC Communications Inc. (SBC) supports the Commission's and Joint Board's commitment to review the existing rules relating to high-cost universal service support in study areas in which a competitive eligible telecommunications carrier (CETC) is providing services, and support for second lines.[1] However, important as this proceeding may be, it is only part of a larger and necessary effort to reform the Commission's universal service support mechanisms in light of marketplace trends and the requirements of section 254. Unless the Commission adopts rules to eliminate implicit subsidies and permit carriers to charge rational residential prices that bear some relationship to the cost of service (providing support where necessary to maintain affordable prices), the Commission can expect to see CETCs continue to serve only the most profitable business customers and exploit arbitrage opportunities created by the current universal service portability rules. The result will be CETC entry that, rather than "preserv[ing] and advanc[ing]" universal service, weakens and de-stabilizes universal service, contrary to Section 254 of the Act.

The Commission cannot simply nip around the edges. Rather, it must return to basic principles and focus on establishing universal service support mechanisms that reflect the

[1] *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support and the ETC Designation Process*, CC Docket No. 96-45, Public Notice, FCC 03J-1 (rel. Feb. 7, 2003) (Public Notice).

language and goals of section 254. In particular, consistent with Congress's mandate that universal service support be available only to the extent necessary to ensure that essential services are supported, the Commission must limit its high-cost support for CETCs only to services that meet the universal service definition and are offered at an affordable rate. The Commission also should modify the way in which it calculates support for CETCs, and limit support payments to the lesser of the difference between the affordable rate and the CETC's actual cost of providing service or the amount of support available to the ILEC. In addition, the Commission should modify its portability rules to prevent multiple carriers from receiving support for the same customer. Moreover, it should, consistent with the statute and the "essential" requirement in particular, limit support only to primary residential lines/connections and single-line business services/connections. At the same time, the Commission must take steps to ensure that carriers may reform their federal and state rates for non-primary lines to fully recover the cost of providing those services/connections because failure to do so would be confiscatory.

I. BACKGROUND

Prior to the 1996 Act, federal and state regulators relied on implicit subsidies to ensure that all Americans have affordable access to local telephone networks. These subsidies were implemented largely through federally and state regulated rates, and shifted the costs of providing service from (1) rural to urban customers, (2) residential to business customers, (3) basic to vertical services, and (4) local to long distance services. While this structure was effective and enabled carriers to earn a reasonable return in a monopoly environment, it could not be sustained once Congress opened local telecommunications markets to competition in the 1996 Act.

The 1996 Act redrew the telecommunications landscape by eliminating barriers to entry in all telecommunications markets. As implemented by the FCC and state commissions, it permitted CLECs to cherry pick the most lucrative customers and leave high cost customers to ILECs, who must serve such customers at regulated, below-cost rates. The Act thus eliminated the structural underpinnings of the complex system of price controls and implicit subsidies supporting universal service.

Recognizing that the market opening provisions of the Act would render implicit subsidies unsustainable, Congress adopted section 254 to preserve and promote universal service in the new competitive environment. That section required the Commission and states to eliminate implicit subsidies,[2] and replace them with explicit federal and state support mechanisms that are "specific, predictable and sufficient" to "preserve and advance universal service."[3] That section further required the Commission to base its universal service policies on other principles as well, including that: (1) quality services be available at just, reasonable, and affordable rates; and (2) consumers in all regions of the country should have access to telecommunications and information services that are reasonably comparable to services provided in urban areas and that are available at rates that are reasonably comparable to rates charged in urban areas.[4] To these principles, the Commission added the principle that federal support mechanisms should be competitively neutral, and neither advantage nor disadvantage particular service providers or technologies.[5] Section 254 also established a list of specific

[2] 47 U.S.C. § 254(e).

[3] *Id.* at § 254(b)(5).

[4] *Id.* at § 254(b).

[5] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 8801 (1997) (*First Report and Order*).

statutory criteria for designating "core" telecommunications services eligible for universal service support.[6] These criteria (and the "essential" requirement in particular) make clear that Congress intended universal service support mechanisms to be a safety net, providing support only where the cost of deploying a truly essential service or functionality in an area would make it unaffordable at market-based rates.

While the Commission's CALLS Order has reduced the amount of implicit subsidies supporting universal service at the federal level, more work is necessary at the state level. As the Tenth Circuit has recognized, the Commission has not done enough to induce state action to further the requirements of section 254 of the Act. Indeed, with no direction from the Commission, states have done little, if anything, to eliminate the widespread reliance on implicit subsidies in intrastate prices to support universal service, in direct conflict with the Act's requirement that universal service support be specific, predictable, and sufficient. Unless directed otherwise, states likely will continue to ignore the problem, continuing to rely on legacy regulatory constructs such as "value of service" pricing and residual rate-making to achieve universal service goals. But, as Congress recognized, these constructs are doomed to fail in a competitive marketplace. At the end of the day, competitors will continue to target the most lucrative business and high-volume residential customers, leaving ILECs holding the bag for serving the majority of customers at below-cost rates without the benefit of the implicit subsidies on which such rates were based.

Worse yet, the Commission has adopted high cost support policies and rules that have exacerbated the strains on current universal service support mechanisms. For example, in the

[6] *Id*. at § 254(c)(1) (requiring the Commission to consider the extent to which such services: (A) are essential to education, public health or safety (the "essential" requirement); (B) subscribed to by a substantial majority of residential customers; (C) deployed in public telecommunications networks by carriers; and (D) consistent with the public interest, convenience and necessity).

name of promoting competitive neutrality, the Commission has adopted universal service portability rules that provide duplicative and excessive support payments, and actually distort the market, in high cost areas with multiple eligible telecommunications carriers (ETCs).[7] In addition, the Commission has, notwithstanding the recommendations of the Joint Board to the contrary, provided high cost support for non-essential second residential lines/connections and multi-line business services/connections. These and other policies not only are inconsistent with the language of the Act and goals of universal service they have distorted competition and significantly increased the size of the universal service fund, and therefore the cost of telecommunications services for all consumers. As a result, the current high cost universal service support mechanisms are neither specific nor predictable nor sufficient to preserve and enhance universal service.

II. THE COMMISSION SHOULD CONDUCT MEANINGFUL REFORM OF ITS HIGH-COST SUPPORT MECHANISMS BY RETURNING TO FIRST PRINCIPLES.

Fundamental universal service reform now is imperative to achieve Congress's goal of establishing explicit, specific, predictable and sufficient universal service support mechanisms that will ensure the availability of essential services at affordable prices for all Americans in a competitive environment. In related reform proceedings, SBC has, among other things, urged the Commission, consistent with the language of section 254 and the goals of universal service,

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[7] *First Report and Order*, 12 FCC Rcd at 8932-34. Under the Commission's rules, a CETC normally receives the same per-line high-cost support that the ILEC would receive for serving the same customer, irrespective of the CETC's actual cost of providing service. Even worse, as the ILEC loses lines to the CETC its per-line costs increase, and the ILEC is entitled to receive greater per-line high cost universal service support payments, which, in turn, also are available to the CETC for each of the lines it serves. As a consequence, the Commission's rules, which were intended to promote competitive neutrality, not only result in excessive and duplicative support payments they actually distort the market by subsidizing new entrants that may not need support to offer affordable services at market-based rates.

to limit high cost support to essential services that would be unaffordable at market-based rates. In particular, it has encouraged the Commission to establish an "affordability" benchmark based on an end user's ability to bear the cost of service relative to household income, and provide universal service support only where market-based rates would exceed this threshold, and thus be unaffordable. SBC also has exhorted the Commission to adopt rules and policies that would require states to rationalize intrastate rates by eliminating implicit subsidies and allowing rates to rise to levels that are self-supporting and affordable.

Comprehensive and meaningful reform of universal service, and the Commission's high cost support mechanisms in particular, depends on resolution of these issues in the Commission's open *Tenth Circuit Remand* and *Universal Service Definition* proceedings. But such action alone is insufficient. The Commission also must return to first principles in this proceeding, and establish competitively neutral rules regarding the provision of universal service support to competitive ETCs (CETCs). In particular, consistent with section 254, it should provide universal service support payments to CETCs only for services that meet the universal service definition and are offered at an affordable rate. The Commission also should modify the way in which it calculates support for CETCs to ensure that they receive no more support than necessary to ensure that they can offer essential services to end users at an affordable rate. And the Commission should modify its universal service portability rules to prevent multiple carriers from receiving support for the same customer.

A. The Commission Should Provide High Cost Support Only for Core Services offered at an Affordable Rate Consistent with the Requirements of Section 254.

The 1996 Act requires the Commission to modify its rules and policies to preserve and advance universal service consistent with the requirements of section 254 and implement section 214(e), relating to the designation of ETCs. In particular, it requires the Commission to establish universal service support mechanisms based on, among other things, the principles that: (1) quality services be available at "just, reasonable, and affordable" rates; and (2) such mechanisms should be "specific, predictable and sufficient" to preserve and advance universal service.[8] To these, the Commission added the principle that federal universal service support mechanisms should be competitively neutral and neither advantage nor disadvantage particular service providers and technologies.[9] Section 254 further requires the Commission to define which telecommunications services are eligible for universal service support based on specific criteria, including that such services are "essential to education, public health, or public safety."[10] Section 254 thus restricts universal service support only to services that are truly essential and would be unaffordable at market-based rates, and limits support payments to the amount by which a carrier's cost of providing such core services exceeds an affordable rate.[11]

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[8] 47 U.S.C. § 254(b).

[9] *First Report and Order*, 12 FCC Rcd at 8801.

[10] *Id.* at § 254(c)(1). The other criteria are that such services: (1) through the operation of market choices of customers, been subscribed to by a substantial majority of residential customers, (2) are being deployed in public telecommunications networks, and (3) are consistent with the public interest, convenience and necessity. *Id.*

[11] As discussed above, and in more detail in SBC's Comments in the *10th Circuit Remand* proceeding, the Commission should determine whether rates are affordable based on an affordability benchmark.

Section 214 provides that a carrier is eligible to receive universal service support in a particular area only if it offers the "core" universal services defined by the Commission under section 254, and advertises the availability of such services in that area.[12] The Act further provides that a state may, in the case of an area served by a rural telephone company, and shall, in other areas, designate more than one carrier as an ETC, provided each such carrier offers the services supported by the federal support mechanisms under section 254.[13] A carrier thus may obtain ETC status, and become eligible to receive universal service support, only if it provides universal services on terms and conditions that are consistent with the requirements of section 254, including the requirement that it offer such services at an affordable rate.

But the conferral of ETC status does not guarantee payment of universal service support. Rather, it only entitles a carrier to receive support if support is necessary to enable the carrier to offer defined universal services at an affordable rate (that is, where the carrier's costs of providing such services exceeds the affordability benchmark), and only if the carrier actually charges an affordable rate for such services. As a practical matter, universal service support, therefore, will be necessary only where a carrier is unable to charge a rate that would recover the carrier's costs of providing services — *i.e.,* where the "self-supporting" rate exceeds the affordability benchmark or the carrier's rate are capped by law or regulation. Thus, if an ETC offers universal services (or a package of services that includes universal services) at a rate that exceeds the affordability benchmark, it is not entitled under the Act to receive universal service support. In that case, the carrier plainly can recover its costs through market-based rates and does not need a subsidy through universal service support. Likewise, if an ETC charges less than

[12] 47 U.S.C. § 214(e)(1).

[13] *Id*. at § 254(e)(2).

the affordability benchmark for defined universal services, its universal service support should be limited only to the amount by which its cost of providing those services exceeds the benchmark.[14] To the extent a carrier charges less than an "affordable" rate for service, there is no justification or basis in the Act for requiring other carriers and customers to subsidize that service.

B. The Commission Should Modify the Way It Calculates Support for CETCs.

The Commission also should modify the way in which it calculates support for CETCs to ensure that they receive no more support than necessary to ensure the availability of essential services to end users at an affordable rate. In particular, consistent with the language of section 254 and the goals of universal service, it should limit payments to CETCs to the lesser of the difference between the affordable rate for service and the CETC's actual cost of providing service or the per-line support amount available to the ILEC.[15]

Section 254(e) of the Act provides that a carrier that receives Federal universal service support "shall use that support *only* for the provision, maintenance, and upgrading of facilities and services for which the support is intended."[16] However, under the Commission's current universal service portability rules, a CETC is entitled to receive support for each line it serves in a particular study area based on the support the ILEC would have received for serving that line, irrespective of whether its costs are lower than the ILEC's.[17] In addition, where a CETC uses

[14] Until the Commission adopts an affordaibility benchmark, it should use the existing, non-rural ILEC high cost fund benchmark.

[15] Consistent with the principle of competitive neutrality, the Commission should use the same methodology to calculate a CETC's costs as it uses to calculate the incumbent's costs.

[16] 47 U.S.C. § 254(e) (emphasis added). *See also* 47 C.F.R. § 54.7 ("A carrier that receives federal universal service support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended.").

[17] 47 C.F.R. § 54.307(a)(1).

UNEs to provide universal services, it is entitled to receive either the full price of the UNE or the per-line support amount available to the ILEC.[18] In either case, a CETC may receive more support than necessary to enable it to provide universal services at an affordable rate, and thus may use support for purposes other than the provision, maintenance or upgrading of services for which the support was intended. The Commission's universal service portability rules thus are flatly inconsistent with the requirements of section 254(e).

Likewise, they are inconsistent with the goals of universal service. As discussed above, Congress intended universal service support to be a safety net, providing support only where the cost of providing essential services would make those services unaffordable at market-based rates. Congress thus intended to provide universal service subsidies only to the extent necessary to permit an ETC to recover its costs while still charging an affordable rate for supported services.[19] The universal service portability rules conflict with this goal by entitling CETCs to receive more support than necessary to provide universal services at an affordable rate. And, as a consequence, they unnecessarily increase the size of the fund and the cost of telecommunications services for other end users.

The Commission's portability rules also distort competition and encourage gaming by wireless CETCs. For example, the rules apparently have encouraged wireless CETCs or their customers to obtain billing addresses in rural areas where high cost support is available for wireless phones used predominantly in other areas. The South Dakota Telecommunications Association recently documented this phenomenon. In particular, it showed that Western

[18] 47 C.F.R. § 54.307(a)(2).

[19] In other words, universal service support should be limited to no more than the difference between an ETC's cost of providing essential services and the affordable rate, as determined by the affordability benchmark.

Wireless sought portable USF support for 30,108 "working loops" on the Pine Ridge Reservation in South Dakota in the first quarter of 2003 even though, according to 2000 census data, there were only 14,068 residents in 3,922 housing units on the reservation.[20] The rules thus have significantly and artificially increased the number of supported lines, further threatening the long-term viability of the universal service fund.

Where a CETC's costs exceed those of the ILEC, there is no basis to provide the CETC more support than would be available to the ILEC. Providing CETC's more high cost support than would be available to the ILEC would encourage inefficient entry, again distorting competition, providing more support than necessary to ensure that essential services are available to consumers at an affordable rate, and driving up the size of the fund. There is no justification or basis in the Act for requiring other carriers and end users to subsidize an inefficient second network by encouraging uneconomic entry by CETCs in high cost areas. The Commission therefore should limit high cost support payments to CETCs to the lesser of the difference between the affordable rate for service and the CETC's actual cost of service or the per-line support available to the ILEC.

C. The Commission Should Modify the Universal Service Portability Rules to Prevent Multiple Carriers from Obtaining Support for the Same Customer.

The Commission also should modify its universal service portability rules to ensure that no more than one carrier receives support for serving a particular customer. As discussed above, CETCs currently are entitled to receive the same amount of per-line high cost support as the ILEC when serving customers in same study area, irrespective of the CETC's actual cost of providing service. As a consequence, when a rural ILEC loses lines to a CETC, the incumbent must recover its fixed costs from fewer lines, increasing its per-line costs and, in turn, its per-line

[20] Comments of South Dakota Telecommunications Association in WT Docket No. 02-381 (filed Feb. 3,

universal service support payments, which also are available to the CETC for each of the lines it serves. As a consequence, the Commission's portability rules result in excessive and duplicative support payments to serve the same customer, significantly increasing the size of the fund and the cost of telecommunications services for all consumers. In addition, they distort the market by providing CETCs an incentive to serve high cost areas not based on any rational business judgment, but rather in order to obtain a government-mandated, uneconomic subsidy. Accordingly, the Commission should, consistent with section 254 and the goals of universal service, modify its universal service portability rules to ensure that no more than one carrier receives support to serve a single end user.

SBC recognizes that eliminating duplicative support payments could result in support shock to some rate-of-return carriers that have become dependent on universal service subsidies to finance their networks. To avoid market dislocations, the Commission could, for a reasonable transition period, adopt rules that provide limited support to multiple carriers in areas served by rate of return carriers. For example, for a limited period, it could provide payments to the ILEC and a CETC to support no more than one connection per platform to any given customer.

III. THE COMMISSION SHOULD LIMIT HIGH COST SUPPORT ONLY TO PRIMARY RESIDENTIAL LINES AND SINGLE-LINE BUSINESS SERVICES.

The Commission should modify its high cost support rules to limit support only to primary residential lines and single-line business services, and thus eliminate high cost support for second residential connections and multiple business connections. In the *First Report and Order*, the Joint Board recommended that universal service support for designated services be limited to those carried on a single connection to a subscriber's primary residence and to

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businesses with only a single connection.[21] The Joint Board found that high cost support for second residential connections, second residences, and businesses with multiple connections was inconsistent with the Act and the goals of universal service because businesses and residences with multiple connections "presumably [could] afford to pay rates that reflect the carrier's costs to provide the services."[22] The Commission too expressed concern that subsidizing rates for second residential lines and businesses with multiple connections was not consistent with the goals of universal service, and that overly expansive support could harm all consumers by increasing the cost of services for all.[23] Nevertheless, without addressing the merits of whether funding for second or more connections is consistent with the requirements of section 254(c),[24] the Commission decided to maintain support for all lines temporarily.[25] The Commission, however, committed to continue to evaluate whether second residential lines or multiple line businesses should continue to be subsidized through universal service support mechanisms,[26] but has not yet done so.

As discussed above, the universal service fund is under unprecedented financial strain. The contribution base has continued to erode rapidly as customers increasingly purchase bundled service offerings and migrate to services and technologies (such as cable modem services and VOIP telephony) that are not contributing to universal service. At the same time, demand for

[21] *First Report and Order*, 12 FCC Rcd at 8829.

[22] *Id*. at 8828-29.

[23] *Id.* at 8829.

[24] *Id.* at 8830.

[25] *Id.* at 8829-30. *See also id.* at 8927 (expressing concern that an abrupt withdrawal of support for multiple lines could affect the operations of carriers then receiving support for businesses and customers with multiple lines).

[26] *Id.* at 8927; 8829-30.

universal service support continues to grow with no end in sight. The high cost fund, in particular, has continued to increase due, among other things, to increased porting of universal service funding and support for multiple connections to customers in high cost areas. For example, because the Commission provides universal service support for all lines in high cost areas, a rural customer can obtain a subsidized wireline phone for her residence, and subsidized wireless connections for every member of her family. As a consequence, the universal fund may provide support for two, four or more connections for a single residence, grossly inflating the universal service fund and harming all consumers by increasing the cost of telecommunications services across the nation. Such support cannot be squared with the language and goals of section 254.

As the Joint Board correctly concluded over six years ago, support for multiple connections to a residence or business (that is, second residential lines and multi-line business services) is inconsistent with section 254.[27] In particular, second residential and multi-line business connections do not meet the criteria in section 254(c) for universal service support. As an initial matter, such connections are not "essential to education, public health or public safety."[28] By definition, a customer with a non-primary line or connection has an alternative (his or her primary line or connection) available to connect to the public switched telecommunications network (PSTN) and public health and safety agencies. As a consequence,

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[27] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, 12 FCC Rcd 87, 132-33 (1996) (*1996 Recommended Decision*).

[28] 47 U.S.C. § 254(c)(1).

the Commission could not reasonably conclude that a second residential or business connection is in any sense "essential" under section 254(c)(1).[29]

Indeed, the Commission already has concluded, in a similar context, that a service is not "essential" if a reasonable alternative is available (even if that alternative is not identical to the service under review). Thus, in the *First Report and Order*, the Commission determined that higher quality access to the Internet was not "essential," and should not receive universal service funding, because voice grade access was available.[30] Likewise, all non-primary connections are not essential because a customer's primary connection/line necessarily is available as an alternative.

In addition, providing high cost support for second residential lines and multi-line business services or connections is contrary to the public interest. First, providing support for such connections not only *could* significantly increase the size of the fund, it already has. As discussed above, many customers in high cost areas have multiple connections to the PSTN (including one or more wireline and/or wireless connections), all of which are eligible for universal service support. Providing support for all these connections has grossly inflated the universal service fund and increased the cost of telecommunications services for all consumers nationwide. Plainly, there is no basis in the Act, or basic fairness, for shifting the burden of

[29] SBC does not advocate technology-based universal service mechanisms, or precluding wireless carriers from designation as eligible telecommunications carriers to the extent the services they offer are essential and provide the core universal services defined by the Commission. Thus, if an end user in an area eligible for support opts to use a wireless connection as her primary residential line or single-line business connection, that wireless service should be eligible for support if it provides all of the other core services. In that instance, any other connection to that customer (whether wireless or wireline) should not be eligible for support.

[30] *First Report and Order*, 12 FCC Rcd 8822-23.

paying for residential second lines and multi-line business connections/services (which, by definition, are not essential) to other end-users.

Second, subsidizing such non-essential services through universal service support distorts telecommunications markets by encouraging customers in high cost areas to purchase more second residential lines/connections or multi-line business services/connections than they would if they had to bear the true cost of those services. As a consequence, such support diverts resources and capital that could be used more productively in other segments of the industry to support excessive investment in high cost areas. While government subsidies, through universal service support, might be justified to support investment in "essential" services that otherwise might be unaffordable, there is no basis in the Act or sound public policy to interfere with the operation of the market for non-essential services, such as residential second lines/connections or multi-line business services/connections. Only by requiring customers that want non-essential services to pay for them will the Commission encourage sound and efficient investment and competition in telecommunications markets.

Of course, eliminating universal service support for non-primary connections/services is only half the equation. Eliminating such support without taking steps necessary to permit carriers in high cost areas to reform their rates to recover fully the costs of providing non-essential, non-primary connections/services would be confiscatory.[31] It also would do nothing to ensure that customers that want non-essential services bear the true costs for them, and thus

[31] In some states, end-user rates for non-primary lines are capped (in Texas, for example, rates will be capped for two more years). Likewise, the Commission has imposed a cap on the subscriber line charge that may prevent a carrier from recovering its interstate costs for non-primary lines. Eliminating support for non-primary lines without eliminating these caps would prevent carriers from fully recovering their costs of providing non-primary line services. Consequently, the removal of support for non-primary lines must be contingent on and concomitant with the expiration or removal of such regulatory restrictions and the grant of flexibility to permit carriers to price non-primary lines at rates that will permit them to recover their costs.

reduce market distortions artificially low regulated rates. The Commission therefore should make clear that states must permit carriers to rationalize their rates for non-primary connections/services when they remove such services from universal service support. Because the sudden removal of support for non-primary lines could result in "rate shock," the Commission and state reasonably could implement a transitional approach towards the elimination of such support and the concomitant increase in end user rates for non-primary lines.

These steps also are a necessary prerequisite to the adoption of a sustainable bill-and-keep intercarreir compensation regime. A bill-and-keep regime fundamentally is premised on the notion that each carrier will recover its network costs from its own end-users, rather than through the imposition of access or other interconnection charges, which traditionally have included implicit subsidies for universal service. As a consequence, implementation of bill-and-keep requires the elimination of implicit subsidies and implementation of explicit universal service support mechanism where necessary to provide essential services as affordable rates. Failure to take these steps prior to intercarrier compensation reform will undermine, rather than "preserve and advance," universal service contrary to the requirements of section 254.

The Commission therefore should modify its definition of universal service to limit support only to primary residential lines and single-line business services/connections, and eliminate universal service support for multiple connections. The Commission further should ensure that, where a customer is served by more than one carrier (such as by a wireless and wireline carrier), only one of those carriers receives universal service support.

IV. CONCLUSION

For the foregoing reasons, the Commission should modify its high cost universal service support rules as discussed herein.

Respectfully submitted,

/s/ Christopher M. Heimann

Christopher M. Heimann
Gary L. Phillips
Paul K. Mancini

SBC COMMUNICATIONS INC.

1401 Eye Street, NW
Suite 400
Washington, D.C. 20005
Phone – 202-326-8909
Facsimile – 202-408-8745

Its Attorneys

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